



DEPARTMENT OF DEFENSE

AUDIT REPORT

ADMINISTRATION OF RENTAL OF DoD PLANT EQUIPMENT
AT SACO DEFENSE INCORPORATED

No. 90-065

May 9, 1990

*Office of the
Inspector General*

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

May 9, 1990

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT)
DIRECTOR, DEFENSE LOGISTICS AGENCY**

**SUBJECT: Report on the Audit of the Administration of Rental of
DoD Plant Equipment at Saco Defense Incorporated
(Report No. 90-065)**

This is our final report on the Audit of the Administration of Rental of DoD Plant Equipment at Saco Defense Incorporated (Saco) for your information and use. Comments on a draft of this report were considered in preparing the final report. This is the second in a series of reports issued as part of our ongoing audit of the Administration of Contractor Rental of DoD Plant Equipment and Collection of Nonrecurring Costs. Nonrecurring cost issues will be addressed in a separate report. We made the audit from January through November 1989. The objectives of the audit addressed in this report were to determine whether contracting officers adequately administered contractors' rental of DoD plant equipment and to evaluate the effectiveness of related internal controls. DoD provided \$6.2 billion of plant equipment to contractors on 3,789 contracts as of September 30, 1987, and of this total, Saco received \$17.6 million of plant equipment.

The audit showed that the procurement and administrative contracting offices properly administered Saco's rental of DoD-owned plant equipment, except for one instance related to interest on late payments. During FY 1988, rent payments of \$153,294 were accurate and collected on time. In FY 1987, the assessment and collection of \$113,586 of interest for prior years' late rent payments were not correctly handled. The audit did not identify systemic internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. The results of the audit are summarized in the following paragraphs, and the details, audit recommendations, and management comments are in Part II of this report.

Interest of \$113,586 due from the contractor for late rent payments was improperly offset against contractor costs to rehabilitate DoD-owned plant equipment. As a result, DoD paid for the rehabilitation costs through overhead costs included in production contract prices, and again through a contract modification that allowed the offset. We recommended that the interest be collected from the contractor, and that the contracting officers at the Defense Contract Administration Services Region, Boston, be instructed on the handling of interest on late rent payments and the related requirements of

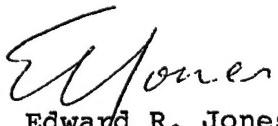
United States Code, title 31, sec. 3302, to deposit miscellaneous receipts with the U.S. Treasury (page 5).

On January 26, 1990, we provided a draft of this report to the Assistant Secretary of the Army, Financial Management, and the Director, Defense Logistics Agency. We received comments from the Director, U.S. Army Contracting Support Agency, dated March 19, 1990; and the Director, Defense Logistics Agency, dated March 29, 1990. The management comments are summarized below and in Part II of this report, and the complete texts of the comments are included in Appendixes A and B.

The Director, U.S. Army Contracting Support Agency, concurred with the finding, Recommendation 1., and the monetary benefits of \$113,586 (Appendix C). The U.S. Army Armament, Munitions and Chemical Command established an accounts receivable and issued a demand letter for \$113,586 to the contractor on February 6, 1990. The Director, Defense Logistics Agency concurred with Recommendation 2., and has provided contracting officers of all Defense Contract Administration Services Regions with instructions regarding the handling of interest on late rent payments and the related requirements of U.S. Code, title 31, sec. 3302, for depositing miscellaneous receipts to the U.S. Treasury.

The management responses to a draft of this report conformed to the provisions of DoD Directive 7650.3. Accordingly, additional management comments on the final report are not required.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Michael Joseph at (202) 693-0138 (AUTOVON 223-0138) or Mr. David Steensma at (202) 694-1681 (AUTOVON 224-1681). A list of the audit team members is in Appendix E. Copies of this report are being provided to the activities listed in Appendix F.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army

REPORT ON THE AUDIT OF THE ADMINISTRATION
OF RENTAL OF DOD PLANT EQUIPMENT
AT SACO DEFENSE INCORPORATED

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Prepared by:
Financial Management Directorate
Project No. 9AC-0022.02

REPORT ON THE AUDIT OF THE ADMINISTRATION
OF RENTAL OF DOD PLANT EQUIPMENT
AT SACO DEFENSE INCORPORATED

PART I - INTRODUCTION

Background

Contractors are ordinarily required to furnish all property necessary to perform Government contracts. In some circumstances, however, it is in the best interest of the Government to furnish certain items of property to the contractors. When contractors have Government property in their custody, the Government contracting officers must ensure that the property is used to the maximum extent possible in performing Government contracts, provide written approval before permitting the contractors to use the property for non-Government work, and charge appropriate rental fees when the property is authorized for use on other than a rent-free basis.

The Federal Acquisition Regulation (FAR), Subpart 45.1, defines plant equipment as personal property of a capital nature for use in manufacturing supplies or performing services, or for any administrative or general plant purpose. Plant equipment includes equipment, machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items, but does not include special tooling or special test equipment.

The contractor determines the non-Government (rent-pay) usage of plant equipment and computes the rent due the Government for each rental period. Within 90 days after the end of each rental period, the contractor must submit a written statement on the use of the property and the rent due to the contracting officer, along with payment.

Rent for plant equipment is calculated using the rates in the FAR, Subpart 52.245-9, "Use and Charges" clause, Table I. The monthly rental rates specified in the FAR are applied to the acquisition cost of the equipment according to the Federal supply class and age of the equipment. Plant equipment rental receipts are deposited in the U.S. Treasury. These offsetting receipts are deducted from budget authority and outlays. Outlays are the amount of checks issued or other payments made, net of refund or reimbursement. With current Gramm-Rudman-Hollings Act restrictions on DoD budget authority, an increase in offsetting receipts would help DoD reach its outlay targets.

FAR, Subpart 45.509, "Care, Maintenance, and Use," requires the contractor to properly care for and maintain Government property. The contractor is required to submit a maintenance program for approval by the Government that includes disclosure and reporting of the need for capital rehabilitation.

Objectives and Scope

The objectives of the audit were to determine whether contracting officers adequately administered contractors' rental of DoD plant equipment and to evaluate the effectiveness of related internal controls.

As of September 30, 1987, Saco Defense Incorporated (Saco), Saco, Maine, had custody of 732 items of DoD-owned plant equipment with an acquisition cost of \$17,561,885. The U.S. Army Armament, Munitions and Chemical Command provided the equipment to the contractor under facilities contract DAAA09-77-E-2022 and follow-on facilities contract DAAA09-88-E-0003. In FY 1988, Saco paid \$153,294 in rent for non-Government use of the DoD-owned plant equipment. The facilities contracts were administered by the Defense Contract Administration Services Management Area, Boston (DCASMA, Boston).

We conducted the audit at the DCASMA, Boston and at Saco. Our review focused on rent paid for non-Government use of DoD plant equipment in 1988, and included a review of related documentation from 1984 to 1989. We reviewed contract documents at the procurement and administrative contracting offices, and sales and expense accounts that we selected from the contractor's chart of accounts. We verified the percentage of non-Government use of plant equipment at the contractor location and the accuracy of rental rates and calculations. We also determined whether the equipment was properly authorized for non-Government use.

This economy and efficiency audit was made from January through October 1989 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly, included such tests of internal controls as were considered necessary. A list of activities visited or contacted is at Appendix D.

Internal Controls

We reviewed the implementation of the Federal Managers' Financial Integrity Act at DCASMA, Boston as it related to our audit scope. The rental of DoD-owned plant equipment was not considered a separate assessable unit at DCASMA, Boston, but was part of the assessable unit called property management. DCASMA, Boston did not provide specific coverage to the rental of DoD-owned plant equipment during its self-evaluation of internal controls over property management.

In discussions with Management it was agreed that the internal control objectives for contractor rental of DoD-owned plant equipment are to ensure that:

- the contractor accurately identifies and reports rent-pay use of the equipment,
- the contractor pays the proper amount of rent, and
- the contractor's rent payments are timely.

Techniques were in place to accomplish the internal control objectives and there was only one isolated case where interest on late rental payments was not properly collected. This case is discussed in detail in Part II of the report.

Prior Audit Coverage

Office of the Inspector General, DoD, Report No. 90-013, "Audit of the Administration of Rental of DoD Plant Equipment at Boeing Helicopters," December 6, 1989, was the first in this series of reports on contractor rental of DoD equipment. The report stated that Boeing Helicopters' rental of DoD equipment was properly administered. A minor underpayment was identified. The contractor remitted the underpayment before the report was issued, so the report contained no recommendations. We did not identify any other prior audit reports on the administration of contractor rental of DoD plant equipment during the last 5 years.

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PART II - FINDING AND RECOMMENDATIONS

Offset of Interest on Late Rent Payments

FINDING

DoD did not collect \$113,586 from Saco Defense Incorporated (Saco) for interest due on late rent payments for use of DoD-owned plant equipment from 1980 through 1985. In 1987, the administrative contracting officer allowed the contractor to offset the interest due against rehabilitation costs incurred and charged to overhead during FY's 1984 and 1985. DoD paid for the rehabilitation of DoD-owned equipment through overhead costs included in production contract prices, and again through a contract modification that allowed the offset of the \$113,586 interest liability against the contractor's rehabilitation costs. As a result, DoD has not been paid the interest due, and the offset of interest was not consistent with U.S. Code, title 31, sec. 3302 requirements for miscellaneous receipts.

DISCUSSION OF DETAILS

Background. The "Use and Charges" clause in FAR, Subpart 52.245-9, provides guidance for calculating rent payments of DoD-owned facilities. Facilities contract DAAA09-77-E-2022 between Saco and the U.S. Army Armament, Munitions and Chemical Command included a provision for Saco to pay interest for late rent payments. In addition, the administrative contracting officer and Saco signed agreements that authorized the use of DoD-owned plant equipment and provided for payment of interest on late rent payments. The U.S. Code, title 31, sec. 3302 requires depositing miscellaneous collections, such as plant equipment rent and interest, to the U.S. Treasury miscellaneous receipts account.

Contract Modification A00018. The administrative contracting officer executed Contract Modification A00018 on March 25, 1987, which offset \$113,586 of interest owed by Saco against costs incurred by the contractor in FY's 1984 and 1985 to rehabilitate DoD-owned plant equipment. The interest was the result of late payments of \$170,664.01 in October 1985 and \$680,610.25 in March 1986 for rental of DoD-owned plant equipment from January 1, 1980, through December 31, 1985. In August 1986, at the request of the administrative contracting officer, the Defense Contract Audit Agency verified the late payment amounts and calculated \$113,586 of interest due.

Saco charged a total of \$131,566.66 to the equipment repair overhead account for rehabilitation of DoD-owned equipment in FY's 1984 and 1985. The contracting officer did not give advance approval or funding of Saco's rehabilitation efforts. Saco proposed to offset the interest liability with rehabilitation costs incurred during FY's 1984 and 1985 on the premise that the

facilities contract required the Government to fund costs for maintenance of DoD-owned equipment that went beyond normal maintenance. The administrative contracting officer agreed with Saco's proposal and issued Contract Modification A00018, which allowed the \$113,586 offset. As part of the modification, Saco reduced its overhead accounts by \$113,586, \$53,061.24 from the 1984 account and \$60,524.76 from the 1985 account. This reduction had no effect on prices already charged to the Government on production contracts because the production contracts between Saco and the Government were firm fixed price. Therefore, DoD did not receive consideration for the interest owed. DoD paid for rehabilitation of its plant equipment through overhead costs included in production contract prices and through the offset of the \$113,586 interest liability for late payments against the rehabilitation costs. The offset of a miscellaneous collection such as interest or rent was not consistent with U.S. Code, title 31, sec. 3302, which requires that receipts be deposited in the U.S. Treasury.

The administrative contracting officer at Defense Contract Administration Services Management Area, Boston did not believe that the contract modification was inconsistent with U.S. Code, title 31, sec. 3302 and further believed that DoD received adequate consideration. An attorney advisor, Office of General Counsel, U.S. Army Armament, Munitions and Chemical Command, agreed with our interpretation that the offset was improper. The current procurement contracting officer was not assigned to the contract when the modification was processed and was not involved with the action. The administrative contracting officer should be informed of the impropriety of the offset and of the requirement to deposit miscellaneous receipts, such as interest or rent, in the U.S. Treasury.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Commander, U.S. Army Armament, Munitions and Chemical Command, establish an account receivable and collect the \$113,586 of interest from Saco Defense Incorporated on late rent payments for use of DoD-owned plant equipment from 1980 through 1985.
2. We recommend that the Director, Defense Logistics Agency, provide contracting officers of the Defense Contract Administration Services Region, Boston with instructions for handling interest on late rent payments and the related requirements of U.S. Code, title 31, sec. 3302 for depositing such miscellaneous receipts to the U.S. Treasury.

MANAGEMENT COMMENTS

The Director, U.S. Army Contracting Support Agency, and the Director, Defense Logistics Agency commented on the finding, recommendations, and monetary benefits. The complete texts of the comments are in Appendixes A and B.

Recommendation 1.

The Director, U.S. Army Contracting Support Agency concurred with the finding, recommendation, and the monetary benefits. The Commander, U.S. Army Armament, Munitions and Chemical Command, has established an accounts receivable in the Standard Army Procurement Appropriations System for the \$113,586 of interest due from Saco Defense Incorporated. In addition, the Command sent the contractor a demand letter on February 6, 1990, requesting reimbursement within 30 days for the accrued interest on late rent payments.

Recommendation 2.

The Director, Defense Logistics Agency concurred with the recommendation. The Chief, Contract Administration Division, commenting for the Defense Logistics Agency, issued guidance to the Defense Contract Administration Services Region, Boston regarding the handling of interest on late payments and the related requirements of U.S. Code, title 31, sec. 3302, for depositing such miscellaneous receipts to the U.S. Treasury. In addition, similar guidance was provided to all Defense Contract Administration Services Regions.

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DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S. ARMY CONTRACTING SUPPORT AGENCY
WASHINGTON, DC 20310-0103



REPLY TO
ATTENTION OF

SFRD-KP

19 MAR 1990

MEMORANDUM FOR INSPECTOR GENERAL, OFFICE OF THE U.S. ARMY
INSPECTOR GENERAL, ATTN: SAIG-PA, WASHINGTON,
DC 20310-1700

SUBJECT: Draft Report on the Audit of the Administration of
Rental of DoD Plant Equipment at SACO Defense
Incorporated (Project No. 9AC-0022.02)

Comments and recommendations on the subject draft report are
enclosed.

J. Bruce King
for NICHOLAS R. HURST

Brigadier General, GS
Director, U.S. Army Contracting
support Agency

J. BRUCE KING
Acting Director
U.S. Army Contracting
Support Agency

U.S. ARMY ARMAMENT, MUNITIONS AND CHEMICAL COMMAND
ROCK ISLAND, ILLINOIS 61299-6000
DRAFT REPORT ON THE AUDIT OF THE
ADMINISTRATION OF RENTAL OF DOD PLANT
EQUIPMENT AT SACO DEFENSE, INCORPORATED
(AMC NO. D8917-A)

OFFSET OF INTEREST ON LATE RENT PAYMENTS

Finding. DOD did not collect \$113,586 from Saco Defense, Incorporated (Saco) for interest due on late rent payments for use of DOD-owned plant equipment from 1980 through 1985. In 1987, the administrative contracting officer allowed the contractor to offset the interest due against rehabilitation costs incurred and charged to overhead during FY 1984 and FY 1985. The DOD paid for rehabilitation of DOD-owned equipment through overhead costs included in production contract prices and again through a contract modification that allowed the offset of the \$113,586 interest liability against contractor incurred rehabilitation costs. As a result, DOD has not been paid the interest due, and the offset of interest was not consistent with United States Code, title 31, section 3302 (U.S.C., title 31, sec. 3302) requirements related to miscellaneous receipts.

Additional Facts. None.

Recommendation Addressed to HQ, AMCCOM and Action Taken.

Recommendation 1. We recommend that the Commander, United States Army Armament, Munitions and Chemical Command, establish an accounts receivable and collect the \$113,586 of interest from Saco Defense, Incorporated on late rent payments for use of DOD-owned plant equipment from 1980 through 1985.

Action Taken. Concur. An accounts receivable has been established in the Standard Army Procurement Appropriation System (SAPAS) for the \$113,586 of interest due from Saco Defense, Incorporated's late rent payments. On 6 February 1990 a letter was sent to Saco requesting reimbursement within 30 days for the accrued interest on the late rent payments.

Monetary Benefit. Concur. As stated in Action Taken, efforts are underway to collect the \$113,586 due from Saco.



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100



IN REPLY A-CI
REFER TO

29 MAR 1990

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on the Audit of the Administration of
Rental of DoD Plant Equipment at SACO Defense
Incorporated (Project No. 9AC-0022.02)

In response to your memorandum dated 23 January 1990, enclosed
are our comments to the draft report.

FOR THE DIRECTOR:

Reathea E. Holmes

REATHEA E. HOLMES
Chief, Internal Review Division
Office of Comptroller

2 Encl

FORMAT 1 OF 2

TYPE OF REPORT: AUDIT

DATE OF POSITION: 29 Mar 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Report on the Audit of the Administration of
Rental of DoD Plant Equipment at Saco Defense
Incorporated (Project No. 9AC-0022.02)

FINDING: Offset of Interest on Late Rent Payments. DoD did not collect \$113,586 from Saco Defense Incorporated (Saco) for interest due on late rent payments for use of DOD-owned plant equipment from 1980 through 1985. In 1987, the administrative contracting officer allowed the contractor to offset the interest due against rehabilitation costs incurred and charged to overhead during FY 1984 and FY 1985. The DoD paid for rehabilitation of DOD-owned equipment through overhead costs included in production contract prices and again through a contract modification that allowed the offset of the \$113,586 interest liability against contractor incurred rehabilitation costs. As a result, DoD has not been paid the interest due, and the offset of interest was not consistent with United States Code, title 31, section 3302 (U.S.C., title 31, sec. 3302) requirements related to miscellaneous receipts.

DLA COMMENTS: Concur that the administrative contracting officer (ACO) improperly set off \$113,586 in interest due on late rental payments against contractor-incurred rehabilitation costs. The ACO should have collected the interest due from the contractor and deposited the money to miscellaneous receipts with the U.S. Treasury. The facilities contract provided for equipment rehabilitation. The PCO should have worked with the ACO to provide the contractor reimbursement through a contract modification for the work performed on Government equipment. However, the PCO never provided funds. As a result, the contractor made necessary modifications to Government equipment by charging the repairs to its normal overhead account. While we concur with the finding, it is our judgement that this is not a material internal control weakness. We will issue a policy letter with additional guidance to the field.

MONETARY BENEFITS: None.

DLA COMMENTS:

ESTIMATED REALIZATION DATE:

AMOUNT REALIZED:

DATE BENEFITS REALIZED:

ACTION OFFICER: Joseph F. Hugar, DLA-ACM, 47644

DLA APPROVAL: Helen T. McCoy

FORMAT 2 OF 2

TYPE OF REPORT: AUDIT

DATE OF POSITION: 29 Mar 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Report on the Audit of the Administration of
Rental of DoD Plant Equipment at Saco Defense
Incorporated (Project No. 9AC-0022.02)

RECOMMENDATION 2: We recommend that the Director, Defense Logistics Agency, provide contracting officers of the Defense Contract Administration Services Region, Boston, with instruction regarding the handling of interest on late rent payments and the related requirements of United States Code, title 31, section 3302 for depositing such miscellaneous receipts to the United States Treasury.

DLA COMMENTS: CONCUR. Guidance has been provided emphasizing that interest be collected on late rental payments, if provided for in the contract, and that United States Code, title 31, section 3302 requires that such interest be deposited in miscellaneous receipts with the U.S. Treasury.

DISPOSITION:

- () Action is ongoing; Final Estimated Completion Date:
(x) Action is considered complete.

MONETARY BENEFITS: None.

DLA COMMENTS:

ESTIMATED REALIZATION DATE:

DATE BENEFITS REALIZED:

ACTION OFFICER: Joseph F. Hugar, DLA-ACM, 47644

PSE REVIEW/APPROVAL: Capt. McNabnay, DLA-AD, 7 Mar 90

DLA APPROVAL: Helen T. McCoy

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**SUMMARY OF POTENTIAL MONETARY AND
OTHER BENEFITS RESULTING FROM AUDIT**

| <u>Recommendation Reference</u> | <u>Description of Benefit</u> | <u>Amount of Benefit</u> |
|---------------------------------|--|--------------------------|
| 1 | Compliance, collection of interest on late rent payment. | \$113,586* |
| 2 | Compliance with existing guidance. | Nonmonetary |

* This is a one-time collection, and the amounts received are deposited to the U.S. Treasury's miscellaneous receipts account. The savings do not affect a specific DoD appropriation.

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ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC

Department of the Army

Assistant Secretary of the Army (Research, Development and Acquisition), Washington, DC

U.S. Army Materiel Command, Alexandria, VA

U.S. Army Armament, Munitions and Chemical Command,
Rock Island, IL

Defense Agencies

Defense Logistics Agency, Alexandria, VA

Defense Contract Administration Services Region, Boston, MA

Defense Contract Administration Services Management Area,
Boston, MA

Defense Contract Audit Agency, Alexandria, VA

Defense Contract Audit Agency Resident Office, Bath Iron Works,
Bath, ME

Non-Government Activities

Saco Defense Incorporated, Saco, ME

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AUDIT TEAM MEMBERS

| | |
|---------------------|--|
| Nancy L. Butler | Director, Financial Management Directorate |
| David K. Steensma | Deputy Director, Financial Management Directorate |
| Michael A. Joseph | Project Manager |
| George J. Sechiel | Team Leader |
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| Katherine E. Newman | Auditor |
| Susanne B. Allen | Editor |

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Army Materiel Command, Alexandria, VA
Army Armament, Munitions and Chemical Command, Rock Island, IL
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Director, Defense Logistics Agency
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Boston, MA
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Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security,
Committee on Government Operations
House Subcommittee on Investigations, Committee on Armed Services

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Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

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